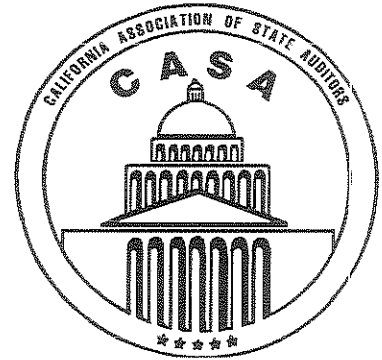


CALIFORNIA ASSOCIATION OF STATE AUDITORS

CASA Officers

President: Richard B. Smith
Vice-President: Roberto Zavala
Secretary: Christine Berthold
Treasurer: Marty Rubio



August 29, 2007

Diana L. Ducay, Chief
Office of State Audits and Evaluation
Department of Finance
300 Capitol Mall, 8th Floor
Sacramento, CA 95814

Dear Ms. Ducay:

This transmits the final report of our external quality control (peer) review of the Department of Finance, Office of State Audits and Evaluations (OSAE) for the audits and reviews completed July 1, 2003 through June 30, 2006. The attached report contains our opinion concerning your organization's overall level of compliance with Government Auditing Standards (GAS). Moreover, the management letter offers observations and recommendations for improvements in OSAE's operations under GAS and your responsive comments to our recommendations.

On behalf of the CASA peer review team, let me once again thank you and OSAE management and staff for their cooperation and assistance. If you have any questions, please contact me at 263-6000.

Sincerely,

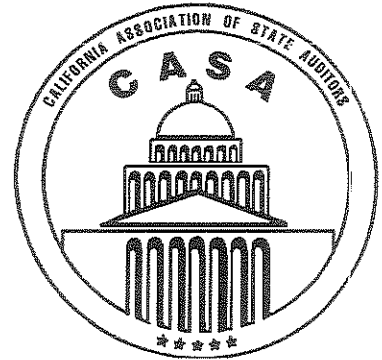
Richard B. Smith
Assistant Executive Director
California Horse Racing Board
Team Leader

Attachments

CALIFORNIA ASSOCIATION OF STATE AUDITORS

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President: Richard B. Smith
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August 29, 2007

Diana L. Ducay, Chief
Office of State Audits and Evaluation
Department of Finance
300 Capitol Mall, 8th Floor
Sacramento, CA 95814

Dear Ms. Ducay:

We completed an external quality control review (Peer Review) of selected audits and reviews completed during the period July 1, 2003, through June 30, 2006, by the Department of Finance, Office of Audits and Evaluations (OSAE). Attachment I lists the audits and reviews we considered in our review. In conducting our Peer Review, we followed the standards and guidelines contained in the CASA Peer Review Guide published by the California Association of State Auditors (CASA). CASA has adopted the Association of Local Government Auditors Quality Control Review Guide and adapted it with input from the Texas State Agency Internal Audit Forum to ensure that the Peer Review meets the needs of agencies under both the United States General Accounting Office (GAO) Government Audit Standards (GAS or Yellow Book) and the Institute of Internal Auditors (IIA) Professional Practices Framework (Red Book). In the performance of its audit work, OSAE cites GAS as its applicable standards.

As prescribed by the CASA Peer Review Guide, we reviewed the internal quality control system of your audit organization and tested a sample of audits conducted by your office for compliance with government audit standards issued by the Comptroller General of the United States. Due to variance in individual performance and judgment, compliance does not imply adherence to standards in every case, but does imply adherence in most situations.

We have concluded that, and it is our opinion therefore, except for the possible effects of the condition noted below, your system of internal quality control was suitably designed and provided reasonable assurance that applicable government auditing standards were followed in your audit work. Instances of nonconformance were determined to be not material to OSAE's overall audit quality and did not compromise the system's ability to ensure adequate quality control. We have also prepared a separate letter to management, which offers suggestions for further strengthening your internal quality control system.

OSAE inhabits a unique niche in the government auditing community. Its organizational location within the Department of Finance (DOF) provides broad access to all Executive Branch State agencies. However, because the DOF establishes certain statewide policies relating to budget preparation and management, accounting/fiscal systems, and information technology; and has oversight responsibility for the entire Executive Branch, the DOF executive

management does not meet specific GAS criteria for independence. Furthermore, by definition, OSAE lacks organizational independence relative to the Executive Branch agencies. OSAE has addressed this situation in two ways. First, for audits wherein it is determined that OSAE lacks independence, disclosure of the potential impairment is included in engagement letters and reports. In cases where OSAE has determined that the engagement is not an audit or attest service, reference to audit standards is not made in its report. We found, in some cases, that OSAE was not clear in the working papers regarding which reports require reference to audit standards. As a case in point, recent internal control reviews of state agencies have been performed without any reference to the standards. Because those engagements were for the most part not included in our sample population, we were unable to assess whether the work complied with applicable audit standards.

OSAE has chosen to apply only GAS for the work it deems to be "audits." The State of California has enacted the Financial Integrity and State Managers' Accountability Act (FISMA), Government Code (GC) Section 13400 et seq. that requires state agencies to review and report upon their internal controls. GC Section 13071 speaks to DOF's responsibility to ensure that state internal audit entities use the IIA Red Book. OSAE has the control agency oversight responsibility to provide guidance to those agencies, including performing external quality assurance reviews and the internal control reviews mentioned above. Given its position as the Executive Branch's audit organization, OSAE determined that it does not conduct internal audit activities within the definition of the IIA standards or Government Code, and that the IIA standards were not applicable to its work.

OSAE has completed significant research into the question of independence and has sought the input of authoritative bodies at the highest levels. This demonstrates OSAE's determination to understand its organizational status clearly and to follow the appropriate standards for its audit work. We believe OSAE should continue to assess its independence on an engagement-by-engagement basis and employ the audit standards that best reflect the nature of each engagement. We question however, the wisdom in not employing the audit standards in engagements where their use appears to be warranted and certainly could have merit.

We have prepared a separate management letter wherein we discuss instances of noncompliance with the standards and our recommendations for corrective action to further strengthen OSAE's internal quality control system.

The CASA Peer Review team thanks OSAE and DOF management for the hospitality and cooperation extended to us during our visit.

This report and the accompanying management letter should be made available to the public and interested parties.

Respectfully submitted,



Richard B. Smith
Assistant Executive Director
California Horse Racing Board
Team Leader

Attachment

ATTACHMENT I

DEPARTMENT OF FINANCE

PEER REVIEW

JULY 1, 2003 THROUGH JUNE 30, 2006

SELECTED ENGAGEMENTS

Fiscal Year	Engagement #	Title	Type	Comments
2003-04	02-6110-192 DOR	A Perfect Balance Child and Adult Care Food Program	Agreed Upon Procedures	E1
2003-04	04-5460-101 DOR	California Youth Authority (CYA) – Karl Horton Youth Correctional Drug and Alcohol Abuse Treatment Facility – Closeout, February 2004	Agreed Upon Procedures	E2
2003-04	03-5175-181 DOR	San Bernardino, Excess Child Support	Agreed Upon Procedures	E3
2003-04	04-5175-014 DIR	Sacramento County Child Support Enforcement Program	Agreed Upon Procedures	E3
2003-04	04-6110-121 DFR	Agreed-Upon Procedures – Childcare Centers	Agreed Upon Procedures	
2003-04	04-3910-034 DPR	G.H. Meiser and Company Rigid Plastic Packaging Container Program – Revised	Agreed Upon Procedures	
2003-04	03-3480-151 DFR	Williamson Act and Open Space Subvention Act Audit Sacramento, Ventura, Solano, Kern, Mariposa, Siskiyou Counties	Compliance	
2003-04	04-8100-019 BO	Desk Review, Women's Crisis Support and Shelter Services, Grant Number DV00151044, DV01161044, RC00191044, RC01201044, SA00041044, SA01051044	Desk Review	E4
2003-04	04-8100-019 BO	Desk Review, Ventura Police Department, Grant Number, JJ98017956, JC98017956, IC98017956, GV99027956, DS99017956	Desk Review	E4
2003-04	04-3360-020 SFR	California Energy Commission Renewable Resource Trust Fund	Financial Statement	E3
2003-04	03-5240-189 SFR	Department of Corrections California Medical Facility Inmate Welfare Fund	Financial Statement	E2
2003-04	03-5240-189 SFR	Department of Corrections Consolidated Inmate Welfare Fund Fiscal Years Ended June 30, 2002 and 2001	Financial Statement	E2
2003-04	02-3910-225 DFR	Equilon Enterprises, LLC, Used Oil Recycling Fee Returns	Grant	E1
2003-04	04-0540-415 DFR	City of South Lake Tahoe Prop 12	Grant	
2003-04	03-4200-227 DIR	Department of Alcohol and Drug Programs	Internal Control Review	E1, E5
2003-04	03-0540-154 DIR	Air Resources Board, Internal Control Review Volume I of II	Internal Control Review	
2003-04	02-0540-158 SAR	Friends of the Urban Forest – Proposition 12 Bond Program Grant Contract 8CA00050	Special Review	E6
2003-04	02-0690-204 BAR	Governor's Office of Emergency Services	Special Review	E6

ATTACHMENT I

DEPARTMENT OF FINANCE PEER REVIEW

JULY 1, 2003 THROUGH JUNE 30, 2006
SELECTED ENGAGEMENTS

2003-04	04-0540-404 DFR 04-0540-510 DFR 04-0540-604 DFR	Management Letter – Audit of Prop. 12, 13, & 40 Bond Funds, Department of Fish and Game	Special Review	E6
2003-04	03-8950-201 BOR	Phase II Independent Review: California Department of Veteran Affairs, The Veterans Home of California at Yountville	Special Review	E6
2004-05	04-3910-040 DPR	California Integrated Waste Management Board (CIWMB) Buy Recycled Program - Molsenbockers	Agreed Upon Procedures	
2004-05	04-6110-121 DFR	California Department of Education (CDE) – San Francisco Community College District (SFCCD), Child & Adult Care Food Program (CACFP), September 2003	Agreed Upon Procedures	
2004-05	03-0845-231 DOI	Conservation and Liquidation Office (CLO) Financial Statement, December 2002	Financial Statement	
2004-05	04-5240-010 DIR	California Department of Corrections and Rehabilitation (CDC) – Community Correctional Facility (CCF) - Taft	Fiscal Compliance	
2004-05	04-3910-095 DFR	Grant Audit City of Lake Elsinore Used Oil Block Grant, Grant UBG6-00-3907	Grant	
2004-05	03-3910-251 DFR	California Integrated Waste Management Board (CIWMB)	Grant	
2004-05	04-0540-418 SFR	Prop. 12 – University of Southern California	Grant	
2004-05	05-0540-400 DFR	Prop. 12 – Philip Williams & Associates	Grant	E3
2004-05	05-0540-401 SFR	Prop. 12 – Greenbelt Alliance	Grant	
2004-05	03-4200-227 DCR	Department of Alcohol and Drug Programs (DADP) – Internal Control Review	Internal Control Review	E6
2004-05	04-4120-059 DER	Special Review Report Los Angeles County Emergency Medical Services Agency AB Trauma Care Fund Program	Special Review	E6
2004-05	05-2740-021 BTR	Department of Motor Vehicles Licensing Fee	Special Review	E6
2004-05	05-8860-069 BO	Department of Finance (DOF) – Peace Officers Procedural Bill of Rights (POBOR) Mandate Study	Special Review	E6
2005-06	05-5175-066 DOR	Department of Child Support Services (DCSS) - Solano County	Agreed Upon Procedures	
2005-06	04-0845-126 DFR	Conservation and Liquidation Office (CLO) 2003 Agreed Upon Procedures	Agreed Upon Procedures	E7

ATTACHMENT I

DEPARTMENT OF FINANCE

PEER REVIEW

JULY 1, 2003 THROUGH JUNE 30, 2006

SELECTED ENGAGEMENTS

2005-06	04-0820-102 DFR	Office of Criminal Justice and Planning (OCJP) - Department of Justice (DOJ) Cold Hit Program	Financial Statement	
2005-06	05-5240-025 DFR	California Department of Corrections and Rehabilitation (CDC) - Community Correctional Facility (CCF) Adelanto, January 2005	Fiscal Compliance	
2005-06	06-3910-066 DFR	California Integrated Waste Management Board (CIWMB) - Fund 100, City of Oceanside UBG6, UBG7, UBG8, February 2006	Grant	
2005-06	05-4260-017 DFR	Department of Health Services (DHS) - Waiver	Independent Assessment	E8
2005-06	06-3960-013 DCR	Department of Toxic Substance Control (DTSC)	Internal Control Review	E8
2005-06	05-5281-022 SC	California Department of Corrections and Rehabilitation (CDC) - Corcoran Regional Accounting Office (RAO), Internal Control Review, November 2004	Internal Control Review	E6
2005-06	05-4260-073 DFR	Department of Human Services (DHS) - Electronic Data Systems (ECS) Contract Follow-Up	Performance Audit	E6
2005-06	05-2240-095 SQ	Department of Housing and Community Development (HCD) - Quality Assurance Review, April 2005	Quality Assurance Review	E6
2005-06	06-3870-004 BIR	CALFED - California Bay-Delta Authority (CBDA), June 2005	Special Review	E6
2005-06	06-0540-504 DFR	Prop. 13 and 50 - Department of Water Resources	Special Review	E7
	06-0540-705 DFR			

ATTACHMENT I

DEPARTMENT OF FINANCE

PEER REVIEW

JULY 1, 2003 THROUGH JUNE 30, 2006

SELECTED ENGAGEMENTS

Exception Legend:

- E1 - Due to limited file space, working papers were archived – not available for review.
- E2 - Alternate sample because E1 working papers were not available for review.
- E3 - DOF tracking System recorded that staff returned the working papers. DOF staff was unable to locate the working papers for the reviewer.
- E4 - DOF performed desk reviews for the Office of Criminal Justice Planning (OCJP) grantee single audit reports. DOF subsequently returned the review sheet and audit reports to OCJP.
- E5 - DOF audit manager informed reviewer that working papers were archived because a subsequent Internal Control Review was performed.
- E6 - Initially selected for review, but was not provided by DOF because GAS Standards were not cited on engagement.
- E7 - Not reviewed due to time constraints.
- E8 - File was reviewed before it was determined that DOF did not cite standards.



DEPARTMENT OF
FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

915 L STREET ■ SACRAMENTO CA ■ 95814-3706 ■ WWW.DOF.CA.GOV

July 20, 2007

Mr. Richard B. Smith, Assistant Executive Director
California Horse Racing Board
1010 Hurley Way, Suite 300
Sacramento, CA 95825

Dear Mr. Smith:

Response to Peer Review Report

Thank you for the opportunity to respond to the external quality control review (peer review) on the Department of Finance, Office of State Audits and Evaluations (OSAE), conducted under the purview of the California Association of State Auditors.

We are pleased that the peer review team found OSAE's system of internal quality control suitably designed to provide reasonable assurance that applicable government auditing standards were followed in our audit work. We offer the following clarification to the issue raised in the peer report:

OSAE's independence impairment with respect to Executive Branch agencies does not determine whether or not the engagement is reported in accordance with audit standards, but rather, the specific nature of the engagement will dictate the applicable standards. We concur that OSAE was not always clear in the working papers regarding which reports required reference to audit standards. OSAE will continue to employ the audit standards that best reflect the nature of each engagement and will document these standards in the working papers.

OSAE is committed to improving its audit processes and welcome the peer reviewers' suggestions. We would like to thank the CASA review team: Richard Smith, Evie Correa, Steve Castillo, and Roberto Zavala for their professionalism and courtesy displayed during the review.

Sincerely,

Original signed by:

Diana L. Ducay, Chief
Office of State Audits and Evaluations
(916) 322-2985

cc: Mr. Roberto Zavala, President, California Association of State Auditors